

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2013-199-WS

IN RE:

Application of United Utility Companies,
Inc. for adjustment of rates and charges
and modifications to certain terms
and conditions for the provision of
water and sewer service.

DIRECT TESTIMONY

OF

STEVEN LUBERTOZZI

Q. WOULD YOU PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS FOR THE RECORD?

A. My name is Steven M. Lubertozzi. I am employed as the Executive Director of Regulatory Accounting and Affairs at Utilities, Inc., through its shared services organization, 2335 Sanders Road, Northbrook, Illinois 60062.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL BACKGROUND.

A. I have been employed by Utilities, Inc., as an employee or independent contractor, since June of 2001. I have been involved in many phases of ratemaking in several regulatory jurisdictions. I have testified in multiple regulatory jurisdictions, including South Carolina, North Carolina, Florida, Illinois, Indiana, Maryland, Kentucky, and New Mexico. I graduated from Indiana University in 1990, and I am a Certified Public Accountant. I earned my Master of Business Administration from Northwestern University's Kellogg School of Management. I am a member of the American Institute of Certified Public Accountants.

Q. WHAT ARE YOUR JOB RESPONSIBILITIES AT UTILITIES, INC.?

1 A. My responsibilities encompass all aspects of utility commission regulation in
2 fifteen of the states where Utilities, Inc. operates (Georgia does not regulate water and
3 sewer utilities). These duties include preparation of rate case applications, coordinating
4 commission audits, developing and delivering testimony before utility commissions and
5 obtaining commission approval of territory expansions.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

7 A. The purpose of my testimony is to sponsor United Utility Companies, Inc.'s
8 application for an adjustment of certain rates and charges for the provision of water and
9 sewer services.

10 **Q. PLEASE DESCRIBE UNITED UTILITY COMPANIES, INC.**

11 A. United Utility Companies, Inc., which I will sometimes refer to as "United" or the
12 "Company", is a wholly owned subsidiary of Utilities, Inc. United was incorporated in
13 1983 for the purpose of owning and operating water utility systems. Currently, United
14 serves approximately 102 equivalent water connections and over 1,000 equivalent
15 wastewater connections in South Carolina. Customer payments, treasury, management,
16 accounting, human resources, and data processing are performed from the Utilities, Inc.,
17 office in Northbrook, Illinois.

18 **Q. WOULD YOU PLEASE DESCRIBE UTILITIES, INC.?**

19 A. Yes. Utilities, Inc. or, as I will sometimes refer to it, "UI", is unique within the
20 water and sewer industry in many respects. From its inception almost 40 years ago, UI
21 has concentrated on the purchase, formation and expansion of smaller water and/or sewer
22 utility systems. Now, UI has over 90 systems that provide service to approximately
23 267,000 equivalent connections in 15 states.

1 **Q. DO UNITED UTILITY COMPANIES, INC.'S CUSTOMERS' BENEFIT FROM**
2 **THE COMPANY'S SUBSIDIARY RELATIONSHIP WITH UTILITIES, INC.?**

3 A. Yes. The Company's relationship with UI has many benefits for our customers.
4 One of the primary benefits is that United has access to a large pool of human resources
5 from which to draw upon. There are experts in various critical areas, such as
6 construction, engineering operations, accounting, data processing, billing, regulation,
7 customer service, etc. This serves United's customers well in that UI is able to provide
8 the highest level of combined expertise and experience in a more cost effective manner.
9 In particular, UI provides managerial and professional services at a cost lower than is
10 available in the open market. United is then able to pass these savings onto its customers
11 in the through lower rates. Because the UI companies are focused on the water and sewer
12 industry, our companies enjoy some unique advantages, one of which is that capital is
13 available for improvements to and expansions of our individual systems at a more
14 reasonable cost than would be the case if the company were not wholly owned by UI.
15 With increasingly more stringent health and environmental standards, ready access to
16 capital will prove vital to continued quality service in the water and sewer utility
17 business.

18 In addition, the UI group of companies has national purchasing power that results
19 in lower costs to ratepayers. Expenditures for insurance, vehicles, chemicals and meters
20 are a few examples of purchases where national contracts provide tangible benefits to
21 ratepayers.

1 **Q. WHY IS UNITED UTILITY COMPANIES, INC. REQUESTING RATE RELIEF**
2 **AT THIS TIME?**

3 A. Under present rates, United is not able to meet its operating costs and earn a
4 reasonable return on its investment in the United system. The utility's current income
5 statement is shown in the Company's Rate Case Application, Schedule B. For the test
6 year ended December 31, 2012, United earned a 1.67% return on its rate base, which is
7 6.97% lower than the Company's current cost of capital, which, as the Commission will
8 hear from the Company's cost of capital witness Dylan D'Ascendis, is 8.64%. This return
9 on rate base is also approximately 400 bps below that authorized in the Commission's
10 last order granting rate relief to United.

11 According to the statistics compiled by the United States Department of Labor
12 Bureau and Labor Statistics, the cost of water and sewer maintenance alone has increased
13 approximately by 7.06% per year in the four years between United's current test year and
14 its previous test year. Without satisfactory rate relief, United's ability to continue to
15 provide safe, reliable and efficient water and sewer utility services to its customers will
16 be placed in jeopardy, and United will be unable to meet its financial obligations.

17 **Q. PLEASE DESCRIBE THE COMPANY'S APPLICATION.**

18 A. The Rate Case Application includes the financial statements for United. The
19 subsections are as follows:

20 Schedule A – Balance Sheet

21 Schedule B – Income Statement

22 Schedule C – Rate Base and Rate of Return

23 Schedule D – Test Year / Present Revenues

1 Schedule E – Proposed Revenues

2 Schedule F – Current and Projected Customers

3 Schedule G – Effect of Proposed Rates

4 Also, included are the most recent letters from DHEC, a sample customer bill form and
5 the Company's most recent Gross Receipts Tax filing. The test year chosen is the year
6 ended December 31, 2012, which was the twelve-month period of the Company's most
7 recent fiscal year available at the time of the Company's filing.

8 **Q. PLEASE EXPLAIN HOW TEST YEAR EXPENSES WERE ADJUSTED.**

9 A. Pro forma adjustments were made to the test year expenses based on known and
10 measurable changes to actual expenses.

11 **Q. WHAT ARE THE KNOWN AND MEASURABLE PRO FORMA ADJUSTMENTS**
12 **MADE TO THE INCOME STATEMENT SCHEDULE B?**

13 A. The following adjustments have been made to the income statement:

- 14 ▪ Revenues are annualized at proposed rates using the average test year
15 customers;
- 16 ▪ Uncollectible Accounts are adjusted based on the percentage of
17 uncollectible accounts to revenues in the test year applied to pro forma
18 proposed revenues;
- 19 ▪ Salaries, Wages and Benefits are adjusted to annualize;
- 20 ▪ Regulatory Commission Expense has been adjusted to reflect the cost of
21 the unamortized balance of the rate case expenses incurred in the prior rate
22 case, the recovery of which was approved in Docket No. 2009-479-WS,

1 Order No. 2012-547 over a three-year period. Current rate case costs have
2 also been amortized over 3 years;

- 3 ▪ Depreciation and Amortization Expense are annualized. Depreciation
4 expense represents gross depreciable plant at the end of the year plus pro
5 forma projects multiplied by their respective depreciation rates;
- 6 ▪ Taxes other than Income is adjusted for annualized payroll taxes, Utility
7 Commission Taxes, and Gross Receipts Taxes;
- 8 ▪ Income Taxes are computed on taxable income at current rates;
- 9 ▪ AFUDC is eliminated for rate making purposes;
- 10 ▪ Interest on debt is computed using a 52.44%/47.56% debt/equity ratio and
11 a 6.60% cost of debt; and;
- 12 ▪ Transportation and depreciation expense for vehicles follow the same
13 allocation methodology as the driver of the vehicle; in other words, the
14 transportation and vehicles costs are allocated to the same systems as the
15 driver of the vehicle;
- 16 ▪ Operating expense charged to plant has been adjusted for projected
17 increases in salaries, taxes, and benefits for operators.

18 The Company's pro-forma operation expenses have increased by 15.88% since the
19 Company last received rate relief. This increase in expenses contributes to the
20 Company's need for rate relief.

21 **Q. WHAT ARE THE PRO FORMA ADJUSTMENTS MADE TO THE RATE BASE**
22 **STATEMENT (SCHEDULE C)?**

23 **A.** The following adjustments have been made to rate base:

- 1 ▪ Plant in Service to reflect adjusted vehicles;
- 2 ▪ Accumulated depreciation and depreciable assets at 1.5%
- 3 ▪ Cash working capital;
- 4 ▪ Pro forma adjustments for actual and estimated plant in service additions,
- 5 some of the drivers for the increase in UPIS rate base are:
- 6 • The installation of several digesters (\$182,000)
- 7 • Building a new catwalk and tank rehabilitation (\$40,000)

8 **Q. HOW DOES THE COMPANY PLAN ON RECOVERING PRUDENTLY**
9 **INCURRED RATE CASE EXPENSE?**

10 A. There are two components of rate case expense included in this case. The first
11 component is the unamortized balance of rate case expense approved in Docket No.
12 2009-479-WS, Order No. 2012-547. The amount approved was \$123,033, which was to
13 be amortized over five years and the unamortized balance, assuming an ORS' audit cutoff
14 of September of 2013 for this case, would be \$92,275. The second component is costs
15 incurred to prepare, respond to discovery, prepare testimony and attend the evidentiary
16 hearing in this case. As the Commission and the ORS are aware, the bulk of the costs
17 incurred to prosecute this rate case are incurred after the ORS audit cutoff date and
18 historically a majority of these rate case expenses are excluded from ORS' testimony,
19 proposed order, and revenue requirement.

20 **Q. HOW SHOULD THESE COSTS BE TREATED?**

21 A. There is no doubt that these costs are prudently incurred and these costs must be
22 included in the Company's revenue requirement.

1 **Q. WHAT IS THE RESULT IF THESE COSTS ARE EXCLDUED IN THE**
2 **COMPANY’S REVENUE REQUIREMENT?**

3 A. The Company would never earn its authorized return.

4 **Q. HOW DOES THE COMPANY PLAN TO SEEK RECOVERY OF THOSE RATE**
5 **CASE EXPENSES THAT ARE INCURRED AFTER THE ORS’ AUDIT CUTOFF**
6 **DATE?**

7 A. United will continue to update its rate case expenses after the ORS’s audit cut-off
8 deadline, and will provide the ORS with periodic updates. United will also make a filing
9 of supplemental rate case expenses with the Commission prior to the final hearing in this
10 matter, and will seek leave to further update its expenses after the conclusion of the
11 hearing. United will ask the Commission to allow recovery of the supplemented
12 expenses.

13
14 **Q. ARE THERE ANY IMPORTANT ISSUES FACING THE WATER INDUSTRY**
15 **THAT YOU WOULD LIKE TO ADDRESS?**

16 A. Yes, arguably one of the most important issues for the industry today is a regulated
17 water company’s reasonable ability to earn its authorized rate of return. Because of its
18 relatively junior size as compared to its gas and electric colleagues, the water industry has
19 not enjoyed some of the same progressive rate mechanisms as its counterparts. As a
20 result, water companies struggle to have even an opportunity to near their authorized
21 ROE, and the US water industry is laser focused on resolving this problem.

22 **Q. HOW DOES NAWC AND NARUC ADDRESS THE ISSUE OF WATER**
23 **COMPANIES NOT EARNING NEAR THEIR AUTHORIZED ROE?**

1 A. Recognizing the problem of reduced earnings and that the regulated compact for
2 water companies was broken the NAWC, sponsored a Resolution Addressing Gap
3 Between Authorized Versus Actual Returns on Equity in Regulation of Water and
4 Wastewater Utilities (“Resolution”) to address these issues. The Resolution passed
5 through the NAWC Water Committee and the NARUC Board unanimously approved the
6 Resolution on Wednesday, July 24, 2013. The NARUC Resolution is designed to
7 address the gap between authorized ROE versus actual or earned ROE. A recent analysis
8 conducted by the NAWC Water Committee showed that as compared to other regulated
9 utility sectors, significant and widespread discrepancies continue to be observed between
10 commission authorized ROEs and observed actual ROEs. Resolution in its entirety is
11 provide below.

12
13 ***Resolution Addressing Gap Between Authorized Versus Actual Returns on***
14 ***Equity in Regulation of Water and Wastewater Utilities***

15
16 WHEREAS, There is both a constitutional basis and judicial precedent allowing
17 investor owned public water and wastewater utilities the opportunity to earn a
18 rate of return that is reasonably sufficient to assure confidence in the financial
19 soundness of the utility and its ability to provide quality service; and

20
21 WHEREAS, Through the *Resolution Supporting Consideration of Regulatory*
22 *Policies Deemed as “Best Practices”* (2005), the National Association of
23 Regulatory Utility Commissioners (NARUC) has previously recognized the role
24 of innovative regulatory policies and mechanisms in the ability for public water
25 and wastewater utilities to address significant infrastructure investment
26 challenges facing water and wastewater system operators; and

27
28 WHEREAS, Public utilities carry the responsibility to invest prudently, provide
29 safe and reliable service, and take reasonable action to take precautionary
30 measures to address business risk and economic forces, as necessary; and

31
32 WHEREAS, Recent analysis shows that as compared to other regulated utility
33 sectors, significant and widespread discrepancies continue to be observed
34 between commission authorized returns on equity and observed actual returns on
35 equity among regulated water and wastewater utilities; and

1
2 WHEREAS, The extent of such discrepancies suggests the existence of
3 challenges unique to the regulation of water and wastewater utilities; and
4

5 WHEREAS, Ratemaking that has worked reasonably well in the past for water
6 and wastewater utilities no longer addresses the challenges of today and
7 tomorrow. Revenue, driven by declining use per customer, is flat to decreasing
8 while the nature of investment (rate base) has shifted largely from plant needed
9 for serve new customers to non-revenue producing infrastructure replacement;
10 and
11

12 WHEREAS, Deficient returns present a clear challenge to the ability of the water
13 and wastewater industry to attract the capital necessary to address future
14 infrastructure investment requirements necessary to provide safe and reliable
15 service, which could exceed one trillion dollars over a 20-year period; and
16

17 WHEREAS, The NARUC Committee on Water recognizes the critical role of the
18 implementation and the effective use of sound regulatory practice and the
19 innovative regulatory policies identified in the *Resolution Supporting*
20 *Consideration of Regulatory Policies Deemed as "Best Practices"* (2005); and
21

22 WHEREAS, It is recognized that state legislative bodies play a significant and
23 important role in considering and addressing the challenges present in the
24 regulation of water and wastewater utilities; therefore, it is critical that economic
25 regulators strive to continue to foster an environment of cooperation and open
26 communication between themselves, legislative bodies, and other state agencies
27 involved in the oversight of water and wastewater utilities such that
28 implementation and effective use of sound regulatory practice and the innovative
29 regulatory policies identified in the *Resolution Supporting Consideration of*
30 *Regulatory Policies Deemed as "Best Practices"* (2005) is both possible and
31 effective; and
32

33 FURTHERMORE, A number of issues have been identified that if addressed
34 may assist in lessening the discrepancy between authorized and actual returns,
35 including: a) reducing, where appropriate, the length of time between rate cases
36 and/or the length of time to process rate cases for regulated water and wastewater
37 utilities; b) reducing rate case expense relative to requested revenue increases
38 through the encouragement of mediation and settlement as appropriate; and c)
39 examining the rate of infrastructure replacement and system improvements
40 among regulated water and wastewater utilities; now, therefore be it
41

42 RESOLVED, That NARUC, convened at its 2013 Summer Meeting in Denver,
43 Colorado, identifies the implementation and effective use of sound regulatory
44 practice and the innovative regulatory policies identified in the *Resolution*
45 *Supporting Consideration of Regulatory Policies Deemed as "Best Practices"*
46 (2005) as a critical component of a water and/or wastewater utility's reasonable
47 ability to earn its authorized return; and be it further
48

49 RESOLVED, That NARUC recommends that economic regulators carefully
50 consider and implement appropriate ratemaking measures as needed so that water

1 and wastewater utilities have a reasonable opportunity to earn their authorized
2 returns within their jurisdictions; and be it further

3
4 RESOLVED, That the Committee on Water stands ready to assist economic
5 regulators with the execution of a sound regulatory environment for regulated
6 water utilities, and will continue to monitor progress on this issue at future
7 national committee meetings until satisfactorily improved.
8

9 The NARUC Resolution along with best practices (Interim Rates, Projected vs.
10 Historical Test Years, Indexes & Pass-Throughs, DSIC, Construction Work in Process,
11 Decoupling, Rate Consolidation and Mediation or Settlement Procedures) and
12 progressive tariffs and are designed to improve returns for shareholders and benefit
13 ratepayers by having improved customer service and slow and steadier increases. The
14 ability to earn an authorized ROE is strongly predicated on the essential regulatory
15 compact. Fortunately, this compact is provided for under the law, and regulated water
16 companies are legally afforded the opportunity to earn a fair return in exchange for
17 providing reliable and quality service.

18 **Q. WOULD YOU PLEASE SUMMARIZE THE PROPOSED CHANGES IN THE**
19 **COMPANY'S RATE SCHEDULE?**

20 A. Exhibit "A" to the Application contains the Company's Schedule of Proposed
21 Water and Sewer Charges. The company has proposed to increase the water customer
22 Residential Base Facility Charge and the Commercial Base Facility Charge from the
23 current charge of \$15.18 per month to \$21.00 per month and the water Commodity
24 Charge from \$7.79 per 1,000 gallons to \$10.77 per 1,000 gallons. The Company has
25 proposed to increase its sewer charges as follows:

Type	Present	Proposed
Residential	\$53.50	\$83.39

1	Commercial SFE	\$53.50	\$83.39
2	Mobile Home	\$39.46	\$61.51
3	Sewer collection	\$27.35	\$42.63
4			

5 **Q. WHAT RATEMAKING METHODOLOGY DOES THE COMPANY PROPOSE**
6 **THAT THE COMMISSION EMPLOY IN THIS RATE CASE?**

7 A. The Company proposes that its rates continue to be determined utilizing the rate
8 of return on rate base methodology. The Company has a large rate base and needs to earn
9 a rate of return that is sufficient to obtain the necessary equity and debt capital that a
10 larger utility needs for sound operation.

11

12 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

13 A. Yes it does.